

**EXECUTIVE  
BOARD  
MEETING**

EBS/21/42  
Correction 1

May 26, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Peru—Review Under the Flexible Credit Line Arrangement**

Board Action: The attached corrections to EBS/21/42 (5/18/21) have been provided by the staff:

**Factual Errors Not  
Affecting the  
Presentation of Staff's  
Analysis or Views**

**Pages 4, 5, 12, 19**

Questions: Mr. Bonato, WHD (ext. 36712)



## CONTEXT

1. **Peru's track record of very strong macroeconomic policies and institutional policy frameworks has served it well.** The successful inflation-targeting regime, the flexible exchange rate, a credible fiscal framework, reflected in the low level of public debt, and sound financial sector supervision and regulation have enabled strong growth over the past 15 years, including across multiple electoral cycles and governments. More recently, the very strong policy frameworks and sizable macroeconomic buffers have allowed the country to deploy a robust policy response to mitigate the socio-economic impact of the COVID-19 pandemic and sustain ample access to international capital markets.
2. **Peru has been hit hard by the COVID-19 pandemic.** As noted in the 2021 Article IV consultation staff report ([IMF Country Report 21/63](#)), the pandemic has taken a heavy toll on lives, and economic activity. The official death toll currently exceeds 64,000, and the death rate is amongst the highest in Latin America. Output contracted by 11.1 percent last year, and despite an expected recovery this year, real GDP would return to its pre-pandemic level only by end-2022. The unemployment rate in the Lima Metropolitan region more than doubled in 2020, rising to 13.9~~0~~ percent from 6.6 percent in 2019, labor market participation fell, and informality increased from already high levels.<sup>1</sup> Despite a large policy response, poverty is estimated to have increased to 27.5 percent in 2020, up from 21.7 percent in 2019.<sup>2</sup> The crisis is likely to leave significant scars in the medium term, and risks to the outlook remain elevated and tilted to the downside.
3. **Policy buffers are ample, and the FCL arrangement has provided added insurance against elevated external downside risks.** The external position strengthened in 2020, and the current account moved into a 0.5 percent of GDP surplus from a deficit of 1.7 percent of GDP in 2019. Substantial foreign borrowing by the public sector in 2020 (US\$7 billion) offset plummeting FDI inflows (down 67 percent), and gross international reserves rose US\$6.5 billion to US\$74.9 billion (36.8 percent of GDP). Peru is a first-time FCL user, and the arrangement has played a key role in supporting the authorities' robust policy response to the COVID-19 pandemic by helping to preserve investor confidence and providing insurance against tail risks.<sup>3</sup>

## RECENT DEVELOPMENTS

4. **A second wave of COVID-19 contagions that began early in 2021 is slowly abating.** The 7-day average of new daily COVID-19 cases has fallen to about 5,000, after peaking at about 9,000 in mid-April. However, the infection levels are similar to those observed in the first wave of the epidemic and continue to stretch capacity in the health sector. Mobility restrictions introduced early in the year have been gradually lifted in some lower-risk areas (Figure 1). Peru has firm contracts for importing some 60 million doses of COVID-19 vaccines, which would cover most of the population

<sup>1</sup> The informal share of employment rose from 71.6 percent in 2019Q3 to 73.7 percent in 2020Q3.

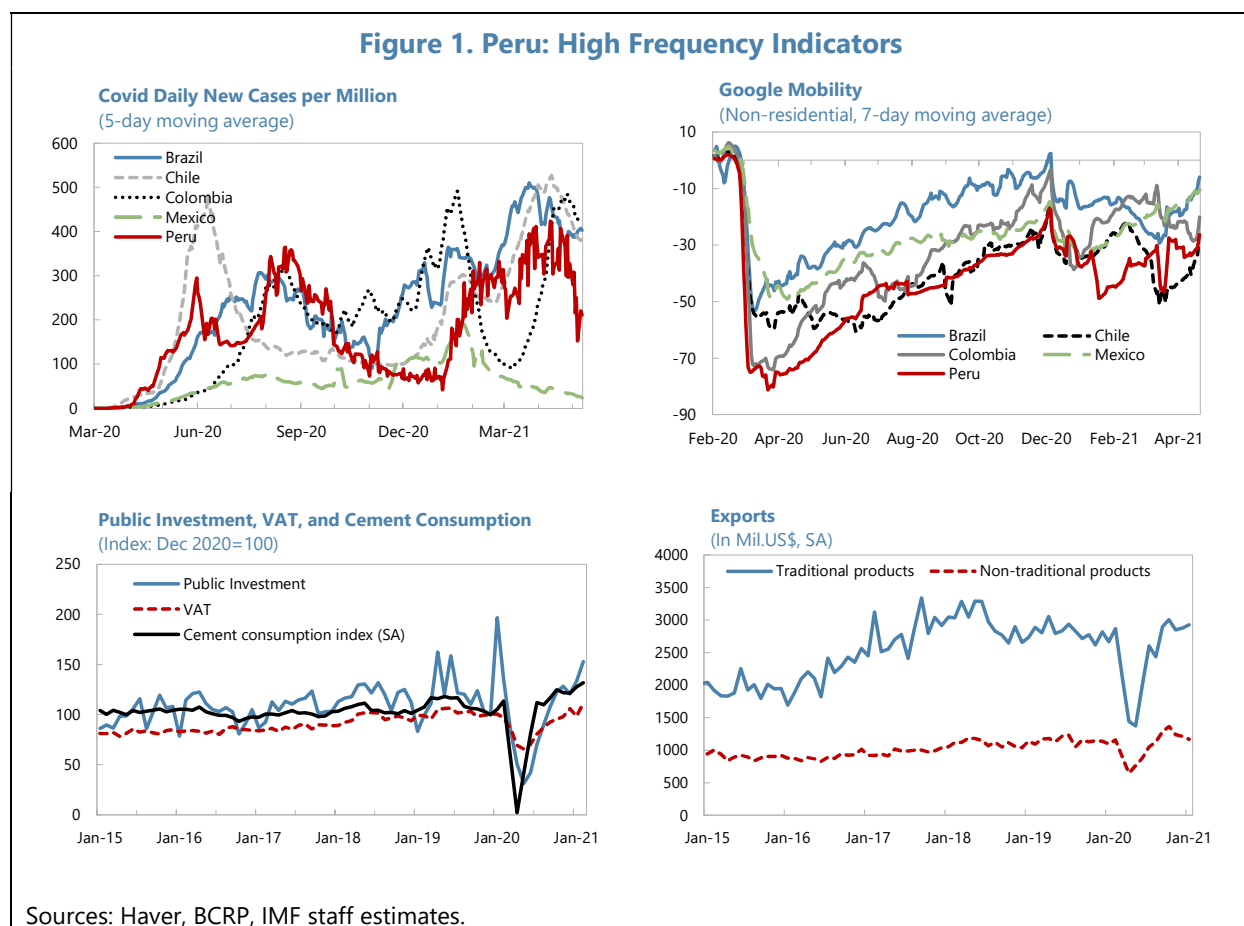
<sup>2</sup> According to the World Bank.

<sup>3</sup> Since the FCL request, the EMBI and 5-year CDS spreads for Peru have compressed by 82 bp and 20 bp, respectively.

(32 million) and is making progress in negotiating with several manufacturers to secure sufficient doses to immunize the entire population. About 754 thousand people had been fully vaccinated as of mid-May and the administration expects the population over 60 years of age to be vaccinated before June, with most of the adult population vaccinated in the second half of the year (reflecting higher expected vaccine availability).

### 5. The latest round of mobility restrictions had a limited effect on economic activity.

Economic activity fell 2.1 percent m/m (sa) in February 2021 (down 4.2 percent y/y), pointing to some upside risk to staff's forecast of a 5.7 percent decline in Q1. High-frequency indicators point to sustained momentum in public investment, cement consumption, and VAT revenues in March. Both traditional and non-traditional exports continued to recover through early 2021, supported by higher commodity prices.<sup>4</sup> However, the labor market continues to underperform: the unemployment rate jumped to 14.5 percent in February, and employment in Lima remains 12.5-0 percent below pre-pandemic levels.<sup>5</sup> Both headline and core inflation have remained within the central bank's target range. The exchange rate has depreciated by 2.1 percent year-to-date, with interventions by the central bank stabilizing recent volatility. International reserves rose by US\$2.4 billion to US\$77.1 billion in April 2021 from end-2020.



<sup>4</sup> Copper prices have increased about 70 percent since April 2020.

<sup>5</sup> Assuming participation rates at pre-COVID-19 levels, the shadow unemployment rate stood at 20.7 percent.

placed sovereign bonds on international markets at favorable terms (US\$2.4 billion in 2017, US\$1.8 billion in 2018, US\$1.9 billion in 2019, and US\$7 billion in 2020, including US\$1 billion in century bonds).<sup>16</sup> At \$5 billion, the latest global issuance in March 2021 covers over 40 percent of the nonfinancial public sector financing requirements. The three major credit rating agencies continue to assign an investment grade rating to Peru (the second highest-rated sovereign in Latin America behind Chile).<sup>17</sup> In staff's assessment, Peru did not lose market access at any point during the last 12 months.

- *Comfortable reserve position.* Gross international reserves reached US\$74.9 billion at end-2020, up from US\$68.4 billion at end-2019, levels that well exceed standard reserve adequacy metrics and compare favorably to peers (Figure 5). After adjusting reserves for FX deposits of the government and commercial banks<sup>18</sup> and augmenting the ARA metric to account for the volatility of Peru's commodity exports,<sup>19</sup> the reserves to ARA metric ratio comes to 189 percent for 2020, and to 136 percent for the average of the past five years.
- *Sound public finances and sustainable public debt.* The fiscal position remains strong, notwithstanding the large policy support deployed in 2020. The public debt sustainability analysis (DSA) indicates that Peru's public debt is expected to remain sustainable with high probability given the projected recovery of the economy in the medium term, and a gradual withdrawal of the fiscal impulse deployed to attend the COVID-19 health emergency (see Figures 1–5, and Annex VIII of the [IMF Country Report No. 21/63](#)). Under staff's baseline scenario, the public debt-to-GDP ratio is forecast to stabilize at about 38 percent of GDP over the medium term. Gross financing needs are expected to average about 5 percent of GDP over the forecast horizon. An elevated share of public debt held by non-residents stands out as the main debt profile risk, along with moderate external financing requirements risks.
- *Low and stable inflation in the context of a sound monetary and exchange rate policy framework.* Peru has maintained low (single-digit) and stable inflation since the introduction of the inflation-targeting framework in 2002. Inflation remains well within the BCRP's target band, including during the past three years, and inflation expectations are well-anchored, with one-year ahead expected inflation remaining at 2.1–3 percent.

<sup>16</sup> Cumulative issuance during 2018–20 is equivalent to about 570 percent of Peru's IMF quota.

<sup>17</sup> Moody's and S&P qualify the outlook for the credit rating as stable. Fitch downgraded the outlook to negative on concerns over political instability, stalling progress on reforms, and curbing economic growth on December 2020. On March 2021, Moody's upgraded the outlook on Peru's banking sector from negative to stable. Peru's credit rating sits comfortably above speculative grade: 1 full grade (3 notches) in the case of Moody's, and two notches above in the case of S&P and Fitch.

<sup>18</sup> The Balance of Payments and International Investment Position Manual classifies international reserves as external assets available for use to meet balance of payments needs and for intervention in exchange markets. Consequently, our adjusted GIR excludes foreign currency deposits of commercial banks and the public sector from the central bank's official GIR number.

<sup>19</sup> Consistent with guidance on assessing reserve adequacy for commodity exporters (Assessing Reserve Adequacy – Specific Proposals, IMF 2014), the ARA metric for Peru is adjusted with a commodity buffer based on a weighted one standard deviation price shock to copper and gold.

Table 1. Peru: Selected Economic Indicators

|  | 2017  | 2018  | 2019  | Prel.<br>2020 | 2021  | 2022  | Proj. |       |       |       |
|--|-------|-------|-------|---------------|-------|-------|-------|-------|-------|-------|
|  |       |       |       |               |       |       | 2023  | 2024  | 2025  | 2026  |
| <b>Social Indicators</b>                                 |       |       |       |               |       |       |       |       |       |       |
| Poverty rate (total) 1/                                  | 24.2  | 22.3  | 21.7  | 27.5          | ...   | ...   | ...   | ...   | ...   | ...   |
| Unemployment rate for Metropolitan Lima (period average) | 6.9   | 6.7   | 6.6   | 13.0          | ...   | ...   | ...   | ...   | ...   | ...   |
| (Annual percentage change; unless otherwise indicated)   |       |       |       |               |       |       |       |       |       |       |
| <b>Production and prices</b>                             |       |       |       |               |       |       |       |       |       |       |
| Real GDP   | 2.1   | 4.0   | 2.2   | -11.1         | 8.5   | 5.2   | 4.8   | 3.4   | 3.3   | 3.3   |
| Output gap (percent of potential GDP)                    | -1.4  | -1.0  | -1.7  | -7.2          | -3.0  | -1.4  | -0.1  | 0.0   | 0.0   | 0.0   |
| Consumer prices (end of period)                          | 1.4   | 2.2   | 1.9   | 2.0           | 2.0   | 2.0   | 2.0   | 2.0   | 2.0   | 2.0   |
| <b>Money and credit 2/ 3/</b>                            |       |       |       |               |       |       |       |       |       |       |
| Broad money  | 8.8   | 9.6   | 8.8   | 27.5          | 13.0  | 9.6   | 7.8   | 7.7   | 6.2   | 5.7   |
| Net credit to the private sector                         | 5.1   | 10.3  | 6.4   | 14.5          | 4.0   | 4.0   | 6.2   | 5.5   | 5.4   | 5.3   |
| Credit-to-private-sector/GDP ratio (%)                   | 40.4  | 42.1  | 43.0  | 53.3          | 48.4  | 47.0  | 46.9  | 47.1  | 47.3  | 47.5  |
| <b>External sector</b>                                   |       |       |       |               |       |       |       |       |       |       |
| Exports  | 22.5  | 8.0   | -2.8  | -11.1         | 27.5  | 3.7   | 3.7   | 3.9   | 4.1   | 4.5   |
| Imports  | 10.2  | 8.1   | -1.9  | -15.6         | 19.9  | 5.0   | 4.8   | 5.0   | 4.8   | 4.5   |
| External current account balance                         | -1.3  | -1.7  | -1.5  | 0.5           | -0.4  | -0.7  | -1.0  | -1.4  | -1.8  | -1.8  |
| Gross reserves In billions of U.S. dollars               | 63.7  | 60.3  | 68.4  | 74.9          | 75.1  | 75.1  | 75.0  | 74.2  | 71.8  | 71.0  |
| Percent of short-term external debt 4/                   | 306   | 364   | 433   | 496           | 519   | 505   | 494   | 506   | 445   | 439   |
| Percent of foreign currency deposits at banks            | 225   | 213   | 224   | 224           | 206   | 204   | 207   | 209   | 211   | 222   |
| (In percent of GDP; unless otherwise indicated)          |       |       |       |               |       |       |       |       |       |       |
| <b>Public sector</b>                                     |       |       |       |               |       |       |       |       |       |       |
| NFPS revenue   | 23.0  | 24.5  | 24.8  | 22.1          | 22.4  | 23.1  | 23.1  | 23.2  | 23.2  | 23.2  |
| NFPS primary expenditure                                 | 24.9  | 25.5  | 25.0  | 29.3          | 25.6  | 24.7  | 24.0  | 23.7  | 23.6  | 23.3  |
| NFPS primary balance                                     | -1.9  | -1.0  | -0.2  | -7.2          | -3.3  | -1.6  | -0.9  | -0.6  | -0.3  | -0.1  |
| NFPS overall balance                                     | -3.1  | -2.3  | -1.6  | -8.9          | -5.0  | -3.4  | -2.8  | -2.4  | -2.1  | -1.8  |
| NFPS structural balance                                  | -2.1  | -1.7  | -0.6  | -6.4          | -4.3  | -3.1  | -2.9  | -2.5  | -2.3  | -2.0  |
| NFPS structural primary balance 5/                       | -0.9  | -0.3  | 0.7   | -4.8          | -2.6  | -1.3  | -1.1  | -0.7  | -0.5  | -0.2  |
| <b>Debt</b>  |       |       |       |               |       |       |       |       |       |       |
| Total external debt 6/                                   | 35.7  | 34.6  | 34.7  | 43.1          | 39.0  | 36.6  | 34.2  | 32.5  | 30.9  | 29.8  |
| Gross non-financial public sector debt 7/                | 25.4  | 26.2  | 27.1  | 35.4          | 35.4  | 36.2  | 36.7  | 37.2  | 37.5  | 37.4  |
| External   | 8.8   | 8.9   | 8.5   | 15.0          | 14.1  | 13.9  | 13.4  | 12.9  | 12.7  | 12.9  |
| Domestic   | 16.7  | 17.3  | 18.6  | 20.3          | 21.3  | 22.3  | 23.2  | 24.3  | 24.8  | 24.5  |
| <b>Savings and investment</b>                            |       |       |       |               |       |       |       |       |       |       |
| Gross domestic investment                                | 20.6  | 21.7  | 21.5  | 18.8          | 21.1  | 22.0  | 22.3  | 22.5  | 22.7  | 22.9  |
| Public sector (incl. repayment certificates)             | 4.6   | 4.8   | 4.6   | 4.2           | 4.1   | 4.1   | 4.1   | 4.2   | 4.2   | 4.3   |
| Private sector   | 17.3  | 17.7  | 18.0  | 16.7          | 16.9  | 17.9  | 18.2  | 18.4  | 18.5  | 18.7  |
| National savings   | 19.3  | 20.0  | 19.9  | 19.3          | 20.7  | 21.3  | 21.3  | 21.2  | 20.9  | 21.1  |
| Public sector  | 1.8   | 2.9   | 3.4   | -3.9          | -0.1  | 1.4   | 2.0   | 2.5   | 2.8   | 3.1   |
| Private sector   | 17.5  | 17.1  | 16.5  | 23.2          | 20.9  | 19.9  | 19.3  | 18.7  | 18.2  | 18.0  |
| <b>Memorandum items</b>                                  |       |       |       |               |       |       |       |       |       |       |
| Nominal GDP (S/. billion)                                | 698   | 740   | 770   | 712           | 815   | 872   | 929   | 976   | 1,024 | 1,075 |
| GDP per capita (in US\$)                                 | 6,726 | 7,000 | 6,958 | 6,084         | 6,678 | 7,051 | 7,389 | 7,644 | 7,901 | 8,180 |

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.

2/ Corresponds to depository corporations.

3/ Foreign currency stocks are valued at end-of-period exchange rates.

4/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.

5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.

6/ Includes local currency debt held by non-residents and excludes global bonds held by residents.

7/ Includes repayment certificates and government guaranteed debt.